

## **FITCH RATES ARLINGTON, TX WATER AND SEWER REVS 'AAA'; OUTLOOK STABLE**

Fitch Ratings-Austin-02 May 2017: Fitch Ratings has assigned a 'AAA' rating to the following City of Arlington, Texas (the city) revenue bonds:

--Approximately \$37.92 million water and wastewater system revenue bonds, series 2017A.

The bonds will be sold via competitive bid on June 13. Series 2017A bond proceeds will be used to improve and extend the city's water and sewer system (the system) and pay issuance costs.

Fitch has also affirmed the following parity system revenues bonds at 'AAA':

--\$153.3 million outstanding water and wastewater system revenue bonds.

The Rating Outlook is Stable.

### **SECURITY**

The bonds are secured by a senior lien on combined net revenues of the system.

### **KEY RATING DRIVERS**

**CONSISTENTLY STRONG DEBT SERVICE COVERAGE:** The financial performance of the system is strong, characterized by solid debt service coverage (DSC) in excess of 2.6x over the past five fiscal years.

**GROWING DIRECT DEBT:** Direct system debt levels, while still adequate for the rating category, are trending upward. The system's capital improvement program (CIP) is manageable and debt levels are projected to remain generally favorable due to the system's rapid principal amortization combined with limited debt issuance plans.

**WHOLESALE COST PRESSURE:** The system is susceptible to operating cost pressure from its wholesale water and wastewater providers. Also, the system's overall debt burden grows significantly when the off-balance-sheet debt of Tarrant Regional Water District (TRWD; revenue bonds rated 'AA'/Outlook Stable) and Trinity River Authority (TRA; revenue bonds rated 'AA+'/'Outlook Stable) is taken into consideration.

**AFFORDABLE USER RATES:** User charges are competitive and among the lowest of other regional providers, despite annual pass-through rate hikes. Rates remain very affordable in relation to area wealth levels.

**STABLE ECONOMY:** The mature service area benefits from its location in the center of the broad and diverse Dallas-Fort Worth Metropolitan Area (MSA).

### **RATING SENSITIVITIES**

**MAINTENANCE OF FINANCIAL PERFORMANCE:** Continued maintenance of strong financial performance, characterized by high debt service coverage, in light of increasing debt costs will be key to maintaining the city of Arlington's high rating.

## CREDIT PROFILE

The system provides retail water service to over 102,000 residential and commercial customers within the city. The city has its own water treatment facilities and purchases raw water supplies on a wholesale basis from TRWD. The sewer system serves over 100,000 connections with wastewater treatment service provided through a contract with the TRA. Total costs for purchased water and sewer treatment from TRWD and TRA equaled 25% and 38% of operating expenses, respectively, in fiscal 2016 and are paid prior to debt service on the bonds.

## HISTORY OF STRONG DEBT SERVICE COVERAGE

Financial performance and operating flexibility are solid. Updates to the system's rate structure from 2004 to 2008, that increased fixed charges while decreasing volumetric rates, led to revenue stability in times of low water sales. The stability in revenues allows the city to more accurately forecast revenues available not only for debt service, but also capital outlays, which is a key factor in limiting the city's need for additional leveraging.

DSC based on a three-year historical average is a very strong 2.9x. Based on budget appropriations, management forecasts that DSC should remain healthy through 2020, not falling below 2.0x. Liquidity improved for fiscal 2016 up to 248 days cash on hand (DCOH) from 172 DCOH the year prior. Cash balances are generally weaker than Fitch's 'AAA' median of 518 DCOH. However, the system's consistent operating revenues, the lack of growth pressure, and practice for budgeting annual depreciation (over \$14 million) all contribute to a very stable operating environment, thereby mitigating the need for higher fund balances.

## MANAGEABLE CAPITAL NEEDS

Capital plans for fiscal years 2017-2021 total \$284 million and will be over 60% debt funded. Direct debt burden is low with debt per customer of \$856, which is on par with the 'AAA' median of \$863. Given planned debt to support capital improvements, debt per capita grows to \$1,350.

The low system leverage is partially a result of the city's purchase of wholesale service but also due to limited growth pressures. In addition, the city has proactive policies of debt amortization and funding annual depreciation from current revenues. As a result, amortization of debt is above average with 64% of all principal maturing in 10 years and 99% in 20 years.

## GROWING DEBT OF WHOLESALE PROVIDERS

Both TRA and TRWD are in capital intensive phases and have notified contracting members that rates will be going up by approximately 10% annually for the next several years. Much of the expansion will be debt funded, adding to the system's annual requirement to both agencies. Arlington is well placed with affordable rates and low debt burden to handle the increases in wholesale provider rates at the current rating.

System user rates are affordable at approximately \$63 a month (based on average residential consumption of 7,500 gallons of water usage and 6,000 for sewer usage), registering at 1.4% of median household income (MHI). This compares well to Fitch's affordability threshold of 2% of MHI and also provides the system flexibility for future rate adjustments.

The city anticipates raising rates between 3% to 9% through 2020 to partially offset the growing rates charged by its wholesale providers. While more significant increases in wholesale charges could pressure user charges, Fitch expects financial margins to remain consistent given the city's policy of passing through provider charges.

## MATURE AND STABLE SERVICE AREA

Arlington (GO IDR 'AAA'/Outlook Stable) is located in the center of the Dallas-Fort Worth Metroplex and had an estimated 2016 population of just over 392,000. The city's proximity to the Dallas-Fort Worth International Airport and a well-developed highway transportation network make the city a logical center for manufacturing, distribution, and trade. Its central location in the Metroplex has also led to the development of sizeable retail trade activity.

Tourism is another important economic component, with Arlington serving as home to the Dallas Cowboys football franchise and the Texas Rangers baseball team. Professional sports and amusement parks are a major draw for residents from the area and around the state. The city's unemployment rate of 4.5% for February 2017 falls in line with the county, MSA and the state but is lower than the nation's 5.1% average. Wealth levels are on par with the state and nation.

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Applicable Criteria  
Revenue-Supported Rating Criteria (pub. 16 Jun 2014)  
<https://www.fitchratings.com/site/re/750012>  
U.S. Water and Sewer Revenue Bond Rating Criteria (pub. 30 Nov 2016)  
<https://www.fitchratings.com/site/re/890402>

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